Knight Vinke Asset Management LLC
489 Fifth Avenue
New York, NY 10017-6100
Tel: 212 660-5720 • Fax: 212 660-5721

Testimony provided to the U.S. House of Representatives, Committee on Financial Services
"Shell Games: Corporate Governance and Accounting for Oil and Gas Reserves",
Wednesday, July 21 2004

Mr Chairman, Ranking Member Frank, and Members of the Committee:

Introduction

My name is Eric Knight and I am the managing director of Knight Vinke Asset Management, a New York based asset management firm registered with the SEC as an Investment Adviser under the Investment Advisers Act of 1940. Our investment strategy involves investing in fundamentally sound public companies where sub-optimal stock market performance can be attributed in some way to poor governance structures and practices, which we interpret in the broadest sense. In such cases, we work with the company's institutional and other shareholders to overcome or redress these governance-related problems and aim, thereby, to obtain a re-rating of the stock and make a profit on our investment.

Through Knight Vinke Institutional Partners ("KVIP"), an investment fund which invests in European equities, we hold approximately 1.32 million shares of Royal Dutch Petroleum with a market value of approximately $70 million. CalPERS, who have a $ 200 million commitment to invest in KVIP, separately also have holdings in Royal Dutch Petroleum ("Royal Dutch") and Shell Transport & Trading ("Shell Transport") amounting to 6.58 million shares and 31.31 million shares, respectively, with a combined market value of approximately $580 million.

We have been working closely with CalPERS and other institutional shareholders of the Royal Dutch Shell Group, both in Europe and in the U.S., with a view to pressing its boards and management into re-examining their unusual governance practices and accepting a more orthodox corporate governance framework.

Knight Vinke Asset Management LLC
489 Fifth Avenue
New York, NY 10017-6100
Tel: 212 660-5720 • Fax: 212 660-5721

Why are we interested in governance at Shell?

Although, as recently as 2002, the boards of the Royal Dutch Shell Group declared that they prided themselves on upholding "the highest standards of integrity and transparency in their governance of the Company" and that they aimed to be "at the forefront of internationally recognised best governance practice" (2002 annual reports), we believe that reality presents a different picture. In light of the multiple reserve restatements over the past few months and the astonishing revelations of the Davis Polk report, shareholders can perhaps be forgiven for being sceptical. The Group concedes that "the framework within which the Boards operate is conditioned to some extent by Royal Dutch's unique relationship with Shell Transport, and this results in some special arrangements which may not be appropriate in other companies". We felt it necessary, therefore, to look carefully into these "special arrangements".

During the course of our due diligence, we asked our counsel in the Netherlands, the U.K. and the U.S. to prepare a report on the Royal Dutch Shell Group's governance structures based on publicly available information and a copy of this report is included in the attached materials (see Exhibit 4).

Shell's Unorthodox Corporate Governance Structures

By way of background, the Royal Dutch Shell Group of companies is 100% owned by two holding companies: Royal Dutch (60%), which is the largest listed company in The Netherlands, and Shell Transport (40%), which is one of the ten largest in the U.K.

Royal Dutch is managed by a Supervisory Board and a Management Board, as is usual in The Netherlands, whereas Shell Transport has a unitary board comprised of non-executives and executives, which is the structure most commonly found in the U.K. It is important to realise, however, that both Royal Dutch and Shell Transport are pure holding companies, with no operating activities of their own.

The following is a summary of some of the more surprising facts which emerged from our analysis:

Knight Vinke Asset Management LLC
489 Fifth Avenue
New York, NY 10017-6100
Tel: 212 660-5720 • Fax: 212 660-5721

- The operating companies of the Royal Dutch Shell Group (i.e. the group of companies below the two parent holding companies) are managed on a day-to-day basis by an informal committee of senior managers -- the so-called "Committee of Managing Directors" (or CMD) – and not by a chief executive officer. Substantial power and autonomy is given to the CEOs of each of the Group's four main Operating Companies, and, although there is a chairman of the CMD, none of these executives reports formally to this person.
- The "boards" of Royal Dutch and Shell Transport are comprised of different groups of individuals – responsible to separate shareholder constituencies -- and it is unclear, therefore, exactly to whom the CMD and its Chairman report or are accountable. The two parent company boards come together on a regular basis in a large gathering known as "the Conference", but this is yet another informal body, vested with no formal powers and unaccountable directly to the shareholders of either holding company.
- The Royal Dutch supervisory board (perhaps the most powerful of the different Shell governing bodies as it controls the majority shareholder in the operating companies) is effectively a close-knit, self-perpetuating body. This results from the existence of a class of so-called "priority" shares, which have the exclusive right to nominate board representatives at Royal Dutch and to reject nominations by shareholders. As of now, the members of the Royal Dutch supervisory and management boards hold or control 100% of these priority shares and thus have the ability to control their own nominations. This self-perpetuating mechanism is wholly inconsistent with internationally accepted principles of good governance.

Despite mounting evidence of poor internal communication, inadequate controls, lack of accountability and unclear reporting lines, Shell's management and board members still maintain that the reserves débacle had nothing to do with structure.

We disagree. Shell's management has operated for years, indeed decades, with none of the basic building blocks of modern governance: its divisional management did not report

Knight Vinke Asset Management LLC
489 Fifth Avenue
New York, NY 10017-6100
Tel: 212 660-5720 • Fax: 212 660-5721

formally to a group chief executive; its divisional CFOs did not report to a Group CFO; the person presented as the chief executive, the Chairman of the CMD, apparently lacked either the authority, responsibilities or the accountability normally associated with a chief executive; he reported to two boards composed of different individuals, and so effectively to none; and the boards of Royal Dutch were shielded from shareholder intervention through the priority share mechanism which made them a "closed shop". The Royal Dutch Shell Group's unusual board and management structures may not be entirely to blame for the misstatement of reserves, but we believe that they, and the corporate "culture" they foster, certainly contributed to the problem.

Exemption from US Proxy Rules

Royal Dutch – as a "foreign private issuer" – is currently exempt from the "proxy rules" under the U.S. securities laws despite that fact that some $25 billion in market value of its shares are represented on the US markets. Nevertheless, in the buildup to this year's annual meeting Royal Dutch employed a prominent U.S. proxy solicitor to obtain support for a resolution giving a shareholder "discharge" to its Supervisory and Management Board members (see Exhibit 3). In itself, this would not be remarkable were it not for the fact that the resolution was strongly opposed by the mostly European shareholders who attended the annual meeting and that, despite this opposition, the resolution was passed thanks to a large block of proxies coming mostly from the U.S. held by the board.

Approximately 25% of Royal Dutch's shares are held in the U.S. in the form of ADRs and in this context, we ask ourselves:

- Did U.S. shareholders know (or were they made aware) that item 2 of the Agenda, covering approval of the accounts, payment of the dividend <u>and</u> discharge of the board members – all presented as a single item – were in fact separate resolutions, each to be voted on separately?
- Did they know, for instance, that shareholders could have voted <u>in favour</u> of the accounts and the dividend but <u>against</u> the discharges?

Knight Vinke Asset Management LLC
489 Fifth Avenue
New York, NY 10017-6100
Tel: 212 660-5720 • Fax: 212 660-5721

Had Royal Dutch not been exempted from the provisions of the U.S proxy rules, we believe that the SEC could have asked for clarification on these points and that, in light of recent events, the vote could well have gone the other way.

In conclusion, if Shell and other multinationals want substantial access to the U.S. capital markets, it seems anomalous that they should be held to lower disclosure standards than their U.S. peers – and this applies to proxy solicitation just as it does to reserve accounting.

Thank you.

Washington, July 21 2004